

MOCK TEST PAPER-1

FINAL – GROUP – II

PAPER – 7: DIRECT TAX LAWS

SUGGESTED ANSWERS/HINTS

1. (a) As per section 80AC, while computing the total income of an assessee of a previous year (**P.Y.2016-17, in this case**) relevant to any assessment year (**A.Y.2017-18, in this case**), any deduction is admissible, *inter alia*, under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' specified in section 139(1).

Since the firm has not entered into any international transaction or specified domestic transaction and the turnover of the partnership firm has exceeded Rs. 100 lacs in the previous year 2016-17, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2017-18 would be 30th September, 2017 as per section 139(1).

**Computation of total income and tax liability of M/s. ABC Corporation for
A.Y.2017-18**

I. Where the firm files its return of income on 30th September 2017:

Particulars	Rs. in lacs
Gross Total Income	300.00
Less: Deduction under section 80-IA	<u>200.00</u>
Total Income	<u>100.00</u>
Tax liability@ 30%	30.00
Add: Education cess@2% and secondary and higher education cess@1%	<u>0.90</u>
Regular income-tax payable	<u>30.90</u>
Computation of Alternate Minimum Tax payable [Section 115JC]	
Total Income	100.00
Add: Deduction under section 80-IA	<u>200.00</u>
Adjusted Total Income	<u>300.00</u>

Alternate Minimum Tax (AMT) @ 18.5% on Rs. 300 lacs	55.50
Add: Surcharge@12% (Since adjusted total income > Rs. 1 crore)	<u>6.66</u>
	62.16
Add: Education cess@2% and SHEC@1%	<u>1.86</u>
Total tax payable (AMT)	<u>64.02</u>

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2016-17 and it shall be liable to pay income-tax on such total income@18.5% [Section 115JC(1)]. Therefore, the tax payable for the A.Y.2017-18 would be Rs. 64.02 lacs.

Tax credit for Alternate Minimum Tax [Section 115JD]	Rs. in lacs
Total tax payable for A.Y.2017-18 (Alternate Minimum Tax)	64.02
Less: Regular income-tax payable	<u>30.90</u>
To be carried forward for set-off against regular income-tax payable (upto a maximum of ten assessment years).	<u>33.12</u>

II. Where the firm files its return of income on 10th November 2017:

Where the firm files its return on 10-11-2017, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of Rs. 300 lacs would be the total income of the firm.

Particulars	Rs. in lacs
Income-tax@30% of Rs. 300 lacs	90.000
Add: Surcharge@12% (since total income exceeds Rs. 100 lacs)	<u>10.800</u>
Income-tax (plus surcharge)	100.800
Add: Education cess@2% and SHEC@1%	<u>3.024</u>
Total tax liability	<u>103.824</u>

Practical solution regarding obtaining clarifications

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date' 30.9.2017 and claim deduction under section 80-IA. In such a case, the firm can claim deduction of Rs. 200 lacs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section

139(5) within 31.3.2019 (i.e., within one year from the end of A.Y.2017-18) which would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 30.9.2017, its tax liability would stand reduced to Rs. 64.02 lacs, as against Rs. 103.824 lacs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of Rs. 33.12 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2017.

(b) Tax consequences in the hands of the MNO trust and its unit holders

	Particulars	Tax treatment in the hands of	
		MNO Trust (REIT)	Unit Holders
(i)	(ii)	(iii)	(iv)
(1)	Interest income of Rs. 4 crore from High Ltd.	There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from High Ltd., being the special purpose vehicle. Therefore, High Ltd. is not required to deduct tax at source on interest payment to the business trust. However, the business trust has to deduct tax at source under section 194LBA – • @ 10%, on interest component of income distributed to resident unit holders; and • @ 5%, on interest component of income distributed to non-corporate non-resident unit holders and foreign companies.	Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders. The interest component of income received from the business trust in the hands of each unit-holder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

(2)	Dividend income of Rs. 2 crore from High Ltd.	The dividend distributed by the SPV to the business trust is exempt by virtue of section 115-O(7), since the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company. Further, there would be no tax liability in the hands of the business trust, due to specific exemption provided under sub-clause (b) of section 10(23FC).	Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), there would be no tax liability on the dividend component [referred to in sub-clause (b) of section 10(23FC)] of income distributed to unit holders in their hands.
(3)	Short-term capital gains of Rs. 1.5 crore on sale of listed shares of High Ltd.	As per section 115UA(2), the business trust is liable to pay tax@15% under section 111A in respect of short-term capital gains on sale of listed shares of special purpose vehicle.	Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in section 10(23FC)(a) and rental income referred to in section 10(23FCA), received by unit holders is exempt in their hands under section 10(23FD). Hence, the

			impugned income will not have any tax effect in the hands of the unit holders.
(4)	Interest of Rs. 10 lakh received in respect of investment in unlisted debentures of real estate companies	Such interest is taxable@35.535%, being the maximum marginal rate, in the hands of the business trust, as per section 115UA(2).	No tax liability on interest component of income distributed to unit holders by virtue of section 10(23FD).
(5)	Rental income of Rs. 3.50 crores of REIT from directly owned real estate assets	Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA). Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I. The business trust has to deduct tax at source@10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.	The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The rental income component received from the business trust in the hands of each unit-holder would be determined in the proportion of 3.5/11.1, by virtue of section 115UA(1).

2. Computation of Total Income of M/s. Popular Tele films for the A.Y.2017-18

Particulars	Rs.	Rs.
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000

Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% (Note 1)	3,00,000	
Disallowance under section 40A(3A) for aggregate cash payment exceeding Rs. 20,000 in a single day (Note 5)	33,000	
Provision for gratuity (Note 8)	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner Ram (Note 4)	5,00,000	42,83,000
		52,83,000
Less: Interest on income-tax refund (Note 9)		1,20,000
Book Profit		51,63,000
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first Rs. 3,00,000 90%	2,70,000	
On the balance Rs.48,63,000 60%	29,17,800	
	31,87,800	
(ii) Remuneration actually paid or payable (Rs. 30,00,000 to 3 partners) + (Royalty Rs. 5 Lacs to Ram)	35,00,000	
(i) or (ii) whichever is less, is deductible		31,87,800
		19,75,200
Capital Gain		
Short-term capital gain on transfer of land (Note 10)		6,00,000
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		26,95,200
Deductions under Chapter VI-A		Nil
Total Income		26,95,200

Notes:

- As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June, 2016 to 31st March, 2017 is to be disallowed. Excess interest of 3% being Rs.15,00,000 x 3/15 = Rs.3,00,000.
- Even though Mohan is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Mohan should also be subject to the limits prescribed in

section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC)*.

3. As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Mohan represents his HUF in the firm. However, Mohan gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.
4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of Rs. 5 Lacs paid to partner Ram would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.
5. Section 40A(3A) provides for disallowance of any expenditure for which the aggregate payment made is otherwise than by an account payee cheque or account payee bank draft in a single day to a person exceed a sum of Rs. 20,000. Hence, the payments of Rs. 17,000 and Rs. 16,000 in cash on 1.3.2017 to Asif, a hairdresser, shall be disallowed, since the aggregate payment of Rs. 33,000 exceeds the limit of Rs. 20,000.
6. The payment of bill of the assistant cameraman of Rs. 16,000 and Rs. 18,000 respectively on 1st February and 2nd February is not liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has not exceeded Rs. 20,000.
7. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2017 has to be deposited latest by 31st July 2017/ 30th September, 2017 (as the case may be). The firm has paid the tax on 5th July, 2017 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.
8. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of Rs. 2.50 lacs paid to retired employees is allowable as deduction. Hence, the balance provision of Rs. 4.50 lacs (i.e., Rs. 7 lacs – Rs. 2.50 lacs) is to be disallowed.

9. Interest on income-tax refund is assessable under the head "Income from other sources".
10. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [*CIT vs. A. N .Naik Associates (2004) 265 ITR 346 (Bom.)*]. Therefore, distribution of a plot of land on retirement of a partner would attract section 45(4). Rs. 16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be Rs. 6 lacs (i.e., Rs. 16 lacs – Rs. 10 lacs).
3. (a) Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, the accumulated profits immediately before liquidation is Rs. 3,00,000. The share of each shareholder is Rs. 60,000 (being one-fifth of Rs. 3,00,000). An amount of Rs. 60,000 is the deemed dividend under section 2(22)(c). The same is exempt under section 10(34) in the hands of the shareholder, since the company is liable to dividend distribution tax in respect of the same.

Therefore, Rs. 2,00,000 [i.e. Rs. 2,60,000 minus Rs. 60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of Rs. 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of Rs. 1,00,000 of each shareholder. The benefit of indexation is available to the shareholders (since the shares are held for more than 24 months and hence long-term capital asset), but could not be computed in the absence of required information. Since the equity shares are not listed, it would not be liable for securities transaction tax and hence, the capital gain (long term) is not exempt under section 10(38). The benefit of concessional rate

of tax @10% without indexation would also not be available. Hence, such long term capital gain would be taxable @ 20% with indexation benefit.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of *CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj)*. Therefore, exemption under section 54EC will not be available in this case since it is deemed transfer and not actual transfer.

Note: However, in case a view is taken that on liquidation of a company, the shareholders right in the said company is relinquished or extinguished and the consideration received by the shareholder is for such relinquishment or extinguishment of rights of the shareholder, then, this transaction shall be transfer as per section 2(47) and the exemption under section 54EC in respect of the capital gain arising from the said transaction shall be available.

(b) The statement is correct

- (1) **Exemption from STT and CTT:** With effect from 1.6.2016, securities transaction tax is not leviable in respect of taxable securities transactions entered into by any person on a recognised stock exchange located in an International Financial Services Centre (IFSC) where the consideration for such transaction is paid or payable in foreign currency.

Likewise, commodities transaction tax is not leviable in respect of taxable commodities transactions entered into by any person on a recognised association located in unit of IFSC where the consideration for such transaction is paid or payable in foreign currency.

- (2) **Exemption of LTCGs on sale of securities, even if STT is not paid:** Long-term capital gains in respect of income arising from transaction undertaken in foreign currency on a recognised stock exchange located in an International Financial Services Centre would be exempt under section 10(38) even though securities transaction tax is not paid in respect of such transaction.
- (3) **Concessional rate of tax on short-term capital gains, even if STT is not paid:** Short term capital gains arising from **transaction undertaken in foreign currency** on a recognised stock exchange located in an International Financial Services Centre would be taxable at a concessional rate of 15% under section 111A **even though securities transaction tax is not paid** in respect of such transaction.
- (4) **Concessional rate of MAT:** In case of a company, being a unit located in International Financial Services Centre and deriving its income solely in convertible foreign exchange, the minimum alternate tax under section 115JB shall be chargeable at the rate of 9% instead of 18.5%.

- (5) **Exemption from tax on distributed profits:** In case of a company being a unit located in International Financial Services Centre, deriving income solely in convertible foreign exchange, there would be no tax on any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise) on or after 1st April, 2017 out of its current income, either in the hands of the company or the person receiving such dividend.
- (c) Under section 2(22)(e), any payment by a closely-held company by way of loan or advance to its shareholder, being a person who is the beneficial owner of shares, holding not less than 10% of the voting power, is deemed as dividend to the extent to which the company possesses accumulated profits.

Therefore, in order to attract the deeming provisions under section 2(22)(e), the recipient of loan should be a registered shareholder as well as the beneficial owner of shares.

Accordingly, in this case, Rs. 50,000 (i.e., loan to the extent of accumulated profits of MNO Ltd.) would be deemed as dividend in the hands of Mrs. Kashyap, who holds 12% equity shares in MNO Ltd., under section 2(22)(e).

Thereafter, the clubbing provisions under section 64(1)(iv) would be attracted, as per which, income as arises, directly or indirectly, from asset transferred to spouse, otherwise than for adequate consideration, would be included in the hands of the transferor.

If the assets so transferred are shares in a company, the loan taken from the company is deemed as dividend income of the shareholder under section 2(22)(e) to the extent to which the company possesses accumulated profits. Thus, on account of this deeming provision, such loan is treated as income arising from the shares. It was so held by the Madras High Court in *CIT v. Vimalan (A.)* (1975) 98 ITR 529.

Accordingly, as per section 64(1)(iv), such income arising in the hands of the shareholder, Mrs. Kashyap, by virtue of section 2(22)(e) (i.e., deemed dividend of Rs. 50,000) would be included in the total income of Mr. Kashyap, who had transferred the said shares to Mrs. Kashyap without consideration.

4. (a) Section 192(1) requires any person responsible for paying any income chargeable under the head "Salaries" to deduct tax at source. If an employee receives income chargeable under a head other than "Salaries", section 192 does not get attracted at all.

The issue under consideration is whether "tips" received by the hotel-company from its customers and distributed to the employees fell within the meaning of "Salaries" to attract tax deduction at source under section 192.

This issue came up before the Supreme Court in *ITC Ltd. v. CIT (TDS)* (2016) 384 ITR 14 wherein it was observed in respect of tips collected by the company from the customers and distributed to the employees, the person responsible for paying the

employee was not the employer at all, but a third person, namely the customer. As income from tips would be chargeable in the hands of the employees as "Income from Other Sources", on account of such tips being received from customers and not from the employer, section 192 would not get attracted at all.

The Supreme Court further observed that there was no vested right in the employee to claim any amount of tip from his employer. Tips are purely voluntary amounts that may or may not be paid by customers for services rendered to them, and hence, would not fall within the meaning and scope of section 15. Further, the amount of tips collected from the customers by the employer and paid to the employees has no reference to the contract of employment at all. Tips were received by the employer in a fiduciary capacity as trustee for payments that were received from customers which they disbursed to their employees for service rendered to the customer. There was, therefore, no reference to the contract of employment when these amounts were paid by the employer to the employee. Due to this reason the tips received by the employees could not be regarded as profits in lieu of salary in terms of section 17(3). The payments of collected tips included and paid by way of a credit card by a customer, would not be payments made "by or on behalf of" an employer. The contract of employment not being the proximate cause for the receipt of tips by the employee from a customer, such payments would be outside the scope of sections 15 and 17 of the Act.

Applying the rationale of the above Supreme Court ruling to the case on hand, the action of the Assessing Officer in treating the Foodie Ltd as an assessee-in-default for non-deduction of tax at source on the amount of tips collected by it from the customers and distributed to its employees, is **not** correct.

- (b) The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, *inter alia*, for purchase of one residential house situated in India within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of Vikram would amount to "purchase" by Vikram for the purpose of claiming exemption under section 54 [*CIT v. T.N. Arvinda Reddy* (1979) 120 ITR 46 (SC)]. Since such purchase is within the stipulated time of two years from the date of transfer of asset, Vikram is eligible for exemption under section 54. As Vikram has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

There is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes and its income is chargeable under the head "Income from house property". This requirement would be satisfied even when the new house is let out for residential purposes.

- (c) The issue under consideration is whether winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets can be subject to tax at the rate of 30% prescribed under section 115BB.

In *CIT v. Manjoo and Co. (2011) 335 ITR 527*, the Kerala High Court observed that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business.

The unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsalable and have no value except waste paper value and the distributor will get nothing on account of the tickets except any prize winning ticket if held by him, which, if produced will entitle him for the prize money.

Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls.

Therefore, the Kerala High Court held that the rate of 30% prescribed under section 115BB would be applicable on prize money winnings received by a distributor on unsold lottery tickets held by him.

Applying the rationale of the Kerala High Court ruling to the case on hand, the Assessing Officer's intention to tax the prize money received by the distributor on unsold lottery tickets held by him at the rate prescribed under section 115BB is justified.

- (d) As per ICDS V on Tangible Fixed Assets, machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised. Where the spares are capitalised as per the above requirement, the issue as to provision of depreciation arises – whether depreciation can be provided where such spares are kept ready for use or is it necessary that they are actually put to use. This issue was dealt with by the Delhi High Court in *CIT v. Insilco Ltd (2010) 320 ITR 322*. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as

emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is “kept ready for use”. For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term “use” embraces both active use and passive use for business purposes.

5. (a) Mr. Raj is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2017-18, as his total turnover from business exceeds Rs. 1 crore and he has employed “additional employees” during the P.Y.2016-17. Since this is the first year of his new business, emoluments paid or payable during this year shall be deemed to be the additional employee cost.

I If Mr. Raj is engaged in the business of manufacture of computers

Deemed additional employee cost = Rs. 24,000 × 12 × 75 [See Working Note below] = Rs. 2,16,00,000

Deduction under section 80JJAA = 30% of Rs. 2,16,00,000 = Rs. 64,80,000.

Working Note:

Number of additional employees

Particulars	No. of workmen	
Total number of employees employed during the year		350
Less: Casual employees employed on 1.8.2016 who do not participate in recognized provident fund	50	
Regular employees employed on 1.5.2016, since their total monthly emoluments exceed Rs. 25,000	125	
Regular employees employed on 1.9.2016 since they have been employed for less than 240 days in the P.Y.2016-17.	<u>100</u>	<u>275</u>
Number of “additional employees”		<u>75</u>

Note - Since casual employees do not participate in recognized provident fund, they do not qualify as additional employees. In any case, their total monthly emoluments exceed Rs.25,00, and hence do not qualify as additional employees. Further, 125 regular employees employed on 1.5.2016 also do not qualify as additional employees since their monthly emoluments exceed

Rs. 25,000. Also, 100 regular employees employed on 1.9.2016 do not qualify as additional employees for the P.Y.2016-17, since they are employed for less than 240 days in that year.

Therefore, only 75 employees employed on 1.4.2016 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2016-17 is deemed to be the additional employee cost.

II **If Mr. Raj is engaged in the business of manufacture of apparel**

In the case of an assessee engaged in the business of manufacture of apparel, the requirement of minimum period of employment of 240 days in the previous year to qualify as an additional employee for the purpose of deduction under section 80JJAA has been relaxed due to the seasonal nature of business of manufacture of apparel. The minimum period of employment required in case of this industry, to qualify as an additional employee for the purpose of deduction under section 80JJAA, is 150 days. Therefore, if Mr. Raj is engaged in the business of manufacture of apparel, then, he would be entitled to deduction under section 80JJAA in respect of employee cost of regular employees employed on 1.9.2016, since they have been employed for more than 150 days in the previous year 2016-17.

Deemed additional employee cost = Rs. 2,16,00,000 + Rs. 24,000 × 7 × 100 = Rs. 3,84,00,000

Deduction under section 80JJAA = 30% of Rs. 3,84,00,000 = Rs. 1,15,20,000

(b) **Computation of tax liability of Ms. Kavita for A.Y.2017-18**

Particulars	Rs.	Rs.
Indian Income		42,00,000
Foreign Income		<u>6,00,000</u>
Gross Total Income		48,00,000
Less: Deduction under section 80C		
PPF Contribution	1,50,000	
Deduction under section 80D		
Medical insurance premium of mother, being a resident senior citizen, restricted to	<u>30,000</u>	<u>1,80,000</u>
Total Income		46,20,000
Tax on total income		12,11,000
Add: Education cess @ 2%		24,220
Secondary and higher education cess @ 1%		<u>12,110</u>
		12,47,330

Average rate of tax in India [i.e., Rs. 12,47,330/ Rs. 46,20,000 x 100]	27%	
Average rate of tax in foreign country [i.e. Rs. 1,50,000/ Rs. 6,00,000 x 100]	25%	
Doubly taxed income	6,00,000	
Rebate under section 91 on Rs. 6,00,000 @25% (lower of average Indian tax rate and foreign tax rate)		<u>1,50,000</u>
Tax payable in India [Rs. 12,47,330 – Rs. 1,50,000]		<u>10,97,330</u>

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

- (a) The assessee is a resident in India during the relevant previous year.
- (b) The income accrues or arises to him outside India during that previous year.
- (c) Such income is not deemed to accrue or arise in India during the previous year.
- (d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
- (e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, Ms. Kavita is eligible for deduction under section 91 since all the above conditions are fulfilled.

- (c) As per section 154(1) read with section 154(2)(b), an income-tax authority may amend any order passed by it under the provisions of the Income-tax Act, 1961 with a view to rectify any mistake apparent from record, which has been brought to its notice, *inter alia*, by the assessee. In the case of *Hind Wire Industries Ltd. v. CIT* (1995) 212 ITR 639, the Apex Court held that the order once amended can also be rectified subsequently provided the mistake apparent from record is rectifiable under section 154. The Apex Court enlarged the scope of the words used in that section by stating that it does not necessarily mean the original order. It could be any order including the amended or rectified order. The contention of the Assessing Officer is therefore, incorrect.
6. (a) As per section 132(1)(c), authorization for search and seizure can take place if the authority, in consequence of *information in his possession*, has *reason to believe* that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorized.

The Apex Court in *UOI v Ajit Jain [2003] 260 ITR 80* has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute “information” within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the assessment made pursuant to such search was not valid.

- (b) Swift Inc., the foreign company and ABC Ltd., the Indian company are associated enterprises since Swift Inc. is the holding company of ABC Ltd. Swift Inc. sells Laptops to ABC Ltd. for resale in India. Swift Inc. also sells identical Laptops to XYZ Ltd., which is not an associated enterprise. The price charged by Swift Inc. for a similar product transferred in comparable uncontrolled transaction is, therefore, identifiable. Therefore, Comparable Uncontrolled Price (CUP) method for determining arm’s length price can be applied.

While applying CUP method, the price in comparable uncontrolled transaction needs to be adjusted to account for difference, if any, between the international transaction (i.e. transaction between Swift Inc. and ABC Ltd.) and uncontrolled transaction (i.e. transaction between Swift Inc. and XYZ Ltd.) and the price so adjusted shall be the arm’s length price for the international transaction.

For sale of Laptops by XYZ Ltd., Swift Inc. is responsible for warranty for 4 months. The price charged by Swift Inc. to XYZ Ltd. includes the charge for warranty for 4 months. Hence, arm’s length price for Laptops being sold by Swift Inc. to ABC Ltd. would be:

Particulars	No.	Rs.
Sale price charged by Swift Inc. to XYZ Ltd.		18,000
Less: Cost of warranty included in the price charged to XYZ Ltd. (Rs. 2,400 x 4 /12)		800
Arm's length price		17,200
Actual price paid by ABC Ltd. to Swift Inc.		21,000
Difference per unit		3,800
No. of units supplied by Swift Inc. to ABC Ltd.	30,000	
Addition required to be made in the computation of total income of ABC Ltd. (3,800 x 30,000)		11,40,00,000

No deduction under chapter VI-A would be allowable in respect of the enhanced income of Rs. 11.40 crores.

Note: It is assumed that ABC Ltd. has not entered into an advance pricing agreement or opted to be subject to Safe Harbour Rules.

- (c) The matter relates to the admission or rejection of the application filed before the Advance Ruling Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

Clause (i) of the first proviso of section 245R(2) provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court. (except in case of resident falling in sub-clause (iii) of clause (b) of section 245N)

In the above case, no application had been filed or contention urged by the applicant (foreign company) before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. One of the Indian companies, however, had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non-resident. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held by the AAR in *Ericsson Telephone Corporation India AB v. CIT* (1997) 224 ITR 203, the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by the non-resident. Hence, it would not be proper to reject the application of the foreign company relying on clause (i) of the proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

- (d) The original return was filed in time and the proceedings were already taken up for assessment under section 143(2). As per the provisions of section 139(5) the assessee can file the revised return only within a period of one year from the end of the relevant assessment year to which the return relates or before completion of the assessment, whichever is earlier. This period expires on 31.3.2017. Since the revised return was filed by the assessee after this date, i.e., on 5.4.2017, the action of the Assessing Officer in making the assessment in disregard of the revised return filed on 5.4.2017 is correct.

7. (a) (i) As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier.

In the present case, Safe Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contented that the airline company was required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.

The facts of the case are similar to the case of *CIT v. Qatar Airways (2011) 332 ITR 253*, where the Bombay High Court held that the difference between the maximum published price and the minimum fixed commercial price cannot be taken as “additional special commission” in the hands of the agents. This is because the maximum published price is the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price. Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. **It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.**

Applying the rationale of the above case to the case on hand, Safe Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.

Therefore, the contention of the Assessing Officer is not tenable in law.

- (ii) Section 205 of the Income-tax Act, 1961 provides that where tax is deductible at source under the provisions of Chapter XVII, the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income. Section 205, therefore, bars a direct demand being made on an assessee to the extent of tax deducted from the income. The Income-tax Department can recover the tax deducted at source from the tenant and not from Subhash in view of the clear mandate in section 205.

The Karnataka High Court has, in *Smt. Anusuya Alva v. DCIT (2005) 278 ITR 206*, ruled that tax deducted at source by the tenant from the rent paid but not remitted to the credit of the Central Government can be recovered only from the tenant and not from the landlord. Therefore, in view of the clear mandate in section 205, the Assessing Officer is not justified in law in calling upon Subhash to pay the said tax.

- (b) As per the section 245D(6B), the Settlement Commission may amend any order passed by it under section 245D(4) to rectify a mistake apparent from the record, within six months from the end of the month in which the order was passed. Where an application for rectification is made by the Principal Commissioner or Commissioner or the applicant within six months from the end of the month in which the order was passed,

the Settlement Commission may amend its order within a period of six months from the end of the month in which such application has been made.

However, an amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission –

- (1) has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so; and
- (2) has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

(c) (i) The statement is not correct.

As per section 249(3) of the Income-tax Act, 1961, the Commissioner (Appeals) may admit an appeal after the expiry of the period of 30 days specified in section 249(2), if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the prescribed time.

(ii) The statement is not correct.

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed.

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose of the appeal within this period of stay.

Where the appeal has not been disposed of within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. If the appeal is not disposed of within such period or periods, the order of stay shall stand vacated after the expiry of such period or periods.